IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

NO. 77-697

AMERADA HESS CORPORATION, AMINOIL USA, INC., AMINOIL DEVELOPMENT, INC., AMOCO PRODUCTION COMPANY, ASHLAND EXPLORATION, INC., ATLANTIC RICHFIELD COMPANY, BELCO PETROLEUM CORPORATION, CABOT CORPORATION, CHEVRON U.S.A. INC., CITIES SERVICE OIL COMPANY, CONTINENTAL OIL COMPANY, DAMSON OIL CORPORATION, DIAMOND SHAMROCK CORPORATION, ECEE, INC., ENSERCH EXPLORATION, INC., EXXON CORPORATION, FREEPORT MINERALS COMPANY, GENERAL AMERICAN OIL COMPANY OF TEXAS, GETTY OIL COMPANY, GULF OIL CORPORATION, J. M. HUBER CORPORATION, HUNT OIL COMPANY, ET AL., INEXCO OIL COMPANY, KERR-MCGEE CORPORATION, MARATHON OIL COMPANY, MOBIL OIL CORPORATION, PENNZOIL COMPANY, ET AL., PHILLIPS PETROLEUM COMPANY, PINTO, INC., PLACID OIL COMPANY, POGO PRODUCING COMPANY, SHELL OIL COMPANY, SIGNAL PETROLEUM COMPANY, SOHIO PETROLEUM COMPANY, SOUTHERN UNION PRODUCTION COMPANY, SUN OIL COMPANY (DELAWARE), THE SUPERIOR OIL COMPANY, TENNECO OIL COMPANY, TEXACO INC., TEXAS PACIFIC OIL COMPANY, INC., TEXAS PRODUCTION COMPANY, TRANSOCEAN OIL, INC., UNION OIL COMPANY OF CALIFORNIA,

Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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FEDERAL ENERGY REGULATORY COMMISSION.

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CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Amerada Hess Corporation, et al.,[1] conditionally cross-petition for a writ of certiorari to review the Judgment of the United States Court of Appeals for the District of Columbia Circuit entered in "The Second National Natural Gas Rate Cases" on June 16, 1977, in the event petitions for a writ of certiorari filed by other parties below are granted by this Court.

OPINIONS BELOW

The June 16, 1977 Opinion of the Court of Appeals and its Per Curiam Order on Petitions for Rehearing entered August 17, 1977 are not yet reported.[2] This Opinion and Order accompany this petition in a separate volume and are designated as Appendix A and B, respectively. The opinions and orders of the Respondent Federal Energy Regulatory Commission[3] below are set forth in Part 1,

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1. Amerada Hess Corporation, Aminoil USA, Inc., Aminoil Development, Inc., Amoco Production Company, Ashland Exploration, Inc., Atlantic Richfield Company, Belco Petroleum Corporation, Cabot Corporation, Chevron U.S.A. Inc., Cities Service Oil Company, Continental Oil Company, Damson Oil Corporation, Diamond Shamrock Corporation, Ecee, Inc., Enserch Exploration, Inc., Exxon Corporation, Freeport Minerals Company, General American Oil Company of Texas, Getty Oil Company, Gulf Oil Corporation, J. M. Huber Corporation, Hunt Oil Company, Et Al., Inexco Oil Company, Kerr-McGee Corporation, Marathon Oil Company, Mobil Oil Corporation, Pennzoil Company, Phillips Petroleum Company, Pinto, Inc., Placid Oil Company, Pogo Producing Company, Shell Oil Company, Signal Petroleum Company, Sohio Petroleum Company, Southern Union Production Company, Sun Oil Company (Delaware), The Superior Oil Company, Tenneco Oil Company, Texaco Inc., Texas Pacific Oil Company, Inc., Texas Production Company, Transocean Oil, Inc., and Union Oil Company of California [hereinafter referred to as "Producers"].

2. *American Public Gas Association, et al. v. Federal Power Commission,* Nos. 76-2000, *et al.* (D.C. Cir. 1977).

3. Hereinafter referred to as "Commission." The orders at issue herein were issued by the current agency's predecessor, the Federal

Vols. 1 and 2 of the Joint Appendix used in the Court of Appeals.[4]

JURISDICTION

The Judgment of the Court of Appeals was entered on June 16, 1977 and its Order Denying Petitions for Rehearing was entered August 17, 1977. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and § 2101(c) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

This petition is a conditional cross-petition for certiorari. In the event this Court determines that other petitions for certiorari raise issues which require this Court's review, Producers submit that certain additional elements of the Judgment as to which certiorari is sought should then be reviewed by this Court but only in the event that this Court determines such other issues independently warrant exercise of the writ. These additional issues are as follows:

1. Whether under existing constitutional and statutory law, the Court of Appeals erred in affirming the Commission's substantial modification of the basic scope of the underlying rulemaking proceeding respecting the qualifying criteria for

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Power Commission. By the Department of Energy Act, P.L. 95-91, 91 Stat. 565 (1977), the Federal Energy Regulatory Commission assumed all authority exercised previously by the Federal Power Commission relevant to the proceedings below.

4. In the interest of economy, the lengthy opinions and orders of the Respondent Commission have not been reprinted.

the rates established therein without affording affected parties notice or any opportunity to present evidence or comments.

2. Whether the Court of Appeals erred as a matter of law in its application of the "end result" test established in *Permian I*[5] by affirming the Commission opinions which reinstituted the vintaging of "new" natural gas and eliminated the eligibility of certain gas to qualify for the new biennium rates when such gas had previously qualified for such rates.

3. Whether the Court of Appeals erred in affirming the rates established in the opinions of the Commission under review where the Commission, in setting those rates, abused its discretion in patently understating the range of cost estimates utilized in establishing the national ceiling rates by failing to make proper adjustments for the observed decline in drilling productivity and for the demonstrated increases in various cost components of the rate which are documented in the record.

STATUTORY PROVISIONS INVOLVED

The relevant portions of the Natural Gas Act, as amended, 15 U.S.C. 717 *et seq.*, are set forth in Appendix I hereto. Also involved are the Due Process Clause of Amendment V of the Constitution of the United States and Section 3 of the Administrative Procedure Act, 5 U.S.C. § 553.

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5. *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) [hereinafter referred to as *Permian I*].

STATEMENT OF THE CASE

On December 4, 1974, the Commission issued an Order Instituting National Rate Proceeding[6] in Docket No. RM75-14 to determine national rates applicable to sales of "new" natural gas, as defined in its order (JA 1-19).[7] The Commission had previously established a single uniform national rate applicable to all producing areas for post-December 31, 1972 gas supplies for the 1973-1974 biennium in Docket No. R-389-B.[8] Docket No. RM75-14 was initiated to update the rates established in Docket No. R-389-B.

Under the rate structure established in the earlier proceeding in Docket No. R-389-B, sales of *newly dedicated* natural gas could qualify for the "new" gas rates if any one of two criteria were satisfied:

1. the gas was newly dedicated because it was from a well commenced on or after the first day of the biennium; or

2. the gas was from a well otherwise newly dedicated to interstate commerce because initial deliveries in interstate commerce from such well commenced on or after the first day of the biennium.

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6. 39 Fed. Reg. 43093, December 10, 1974.

7. References are to Part I of the Joint Appendix used in the Court of Appeals.

8. Just and Reasonable National Rates For Sales of Natural Gas From Wells Commenced On or After January 1, 1973, and New Dedications of Natural Gas To Interstate Commerce On or After January 1, 1973, Opinion No. 699, 51 F.P.C. 2262, *final order on rehearing* (Opinion No. 699-H), 52 F.P.C. 1604 (1974), *aff'd sub nom. Shell Oil Company v. FPC*, 520 F.2d 1061 (1975), *reh'g denied*, 525 F.2d 1261 (5th Cir.), *cert. denied*, 426 U.S. 941 (1976).

Additionally, gas under "roll-over" contracts qualified for the "new" gas rates, a "roll-over" contract being defined as a contract covering gas flowing in interstate commerce becoming effective on or after January 1, 1973 after the expiration of an existing contract.

The notice initiating the review proceeding as issued herein clearly indicated the Commission's intention to maintain the existing criteria. First, the title of the rule-making itself was indicative of the intended scope of the proceeding, to wit that all gas dedicated to interstate commerce would qualify for the new rates, the proceeding being entitled:

> National Rates for Jurisdictional Sales of Natural Gas Dedicated to Interstate Commerce on or After January 1, 1973, for the Period January 1, 1975 to December 31, 1976.[9]

This intention — to make all such new dedications eligible for the new rate — was further underscored in the body of the Notice, wherein the Commission stated:

> The classes of gas which will qualify for the rates established herein . . . include all gas supplies produced from wells commenced during the 1975-76 biennium and *all new dedications* to interstate commerce during this biennium as well as all such wells commenced *and* dedications made during the new biennium.[10]

Fully in accord with its Notice of Rulemaking, on July 27, 1976, the Commission issued Opinion No. 770[11]

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9. JA 1.

10. JA 2, fn. 3 [emphasis added].

11. Opinion and Order Prescribing Uniform National Rates For Sales of Natural Gas Dedicated To Interstate Commerce On or After

(JA 297-534) in which it determined a new national rate of $1.42 per Mcf subject to a 1¢ per calendar quarter escalation applicable to sales of natural gas from wells commenced on or after January 1, 1975, or for sales of gas newly dedicated to interstate commerce on or after January 1, 1975. This rate was based on an exhaustive analysis of four separate cost studies in the record, one by the undersigned Producers, one by the United Distribution Companies, one by the Bureau of Natural Gas (BNG) of the Commission Staff, and one by the Office of Economics (OEC), also of the Commission Staff. The Commission utilized the two Staff studies, finding that they required a constant price of $1.61 to $1.63 per Mcf (JA 398), a range of $1.50 to $1.729 under the BNG Study (JA 403), and a range of $1.541 to $1.767 under the model set out in the OEC Study (JA 412).

However, contrary to its announced undertaking in Opinion No. 699-H to eliminate vintaging,[12] the Commission proceeded to provide for a proliferation of vintages of "new" gas. "New" gas dedicated to interstate commerce during the 1973-1974 biennium was priced at 93 cents per Mcf,[13] and previously dedicated gas under "roll-over" contracts continued to be priced at the previous rate of 52 cents per Mcf.

The Commission in its rate design then established an initial rate which was approximately 19 cents per

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January 1, 1973, For The Period January 1, 1975 to December 31, 1976, ____ F.P.C. ____ (July 27, 1976).

12. 52 F.P.C., *supra*, at 1637-38.

13. This rate was established by Opinion No. 770-A to correct for a mathematical error in Opinion No. 770; the original rate established in that latter opinion was $1.01 per Mcf.

Mcf below what it found to be the required constant price to arrive at an initial ceiling rate of $1.42 per Mcf with 4 cents per year escalation.[14] The effect of this procedure is to prevent the Producers from collecting even the understated constant price for the first five years that the rates are effective under the Commission's rate structure.

Following the issuance of Opinion No. 770, a total of 27 applications for rehearing, reconsideration, or clarification of Opinion No. 770 were filed by natural gas producers, interstate pipelines, gas distributors, consumer interest groups, State agencies, four United States Senators, 25 members of the United States House of Representatives, and several trade associations. By Order dated September 2, 1977, thirteen specific points were set for oral argument, with a "catch-all" provision at the end allowing for oral argument on any other matter raised. Nowhere was the "wells dedicated" standard, the fundamental well-qualification criterion of the rulemaking, mentioned as an item for oral argument. Oral argument was presented to the FPC by 15 parties on September 16-17, 1976.

On November 5, 1976, the Commission issued its "Opinion and Order on Rehearing Modifying In Part Opinion No. 770 and granting Petitions For Intervention" (JA 581-880). Without prior notice, the Commission modified its "new" gas criterion on "new" wells dedicated, establishing in their place a single criterion that only gas from wells commenced during a particular biennium qualified for the vintage rate applicable to that

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14. In Opinion No. 770, the level rate was slightly higher but was adjusted in Opinion No. 770-A to account for certain mathematical errors.

biennium. Gas otherwise newly dedicated to interstate commerce as a qualifying criterion was for the first time in the proceeding excluded altogether.

Following the issuance of Opinion No. 770-A, petitions for review were filed in eight United States Court of Appeals. By order dated December 30, 1976, the D. C. Circuit determined that it had jurisdiction and venue to review the subject Commission orders and directed the Commission to file the administrative record before it. Recognizing the importance of this case to consumers as well as to the natural gas producing industry, the Court of Appeals provided for expedited briefing. Further, the Court heard two days of oral argument on March 23 and 24, 1977. In its decision, entered June 16, 1977, the Court affirmed the Commission's orders in all respects.

REASONS FOR GRANTING THE WRIT

I. The Court Of Appeals Improperly Approved The Commission's Refusal To Abide By Established Constitutional And Statutory Standards In Establishing The "New" Gas Definition.

In affirming the Commission's major realignment in Opinion No. 770-A of its pre-existing rate structure on qualifying "new" gas, the Court found that Producers had had ample opportunity to respond to the merits of the ultimate change in "new" gas definitions. The Court relied upon the fact that one of the parties to the proceeding had raised the matter in initial comments[15] and had again raised the issue in its petition for rehearing. Further, the

15. Producers would note such comments relied upon no evidentiary support.

Court found that in the First National Rate Proceeding, the Commission had similarly altered the scope of the "new" gas definition in its final order *vis-a-vis* the notice of rule-making, although there the Commission had expanded the definition, rather than contracting it, as here. Having taken such note, the Court rejected the Producers' contentions on the "new" gas definition. However, the two situations are not analogous, and the Court's analysis cannot withstand scrutiny under established principles of statutory and constitutional law.

In the first national rate proceeding, the definitional issue and what qualified as "new" gas was an issue not only in comments but also in the Commission's orders beginning with Opinion No. 699-A.[16] Thereafter, it remained an issue, with the matter being addressed not only in Opinion No. 699-H, but in succeeding orders as well.[17] Thus, the matter was a source of continuing controversy.

No such similar situation occurred here. A definitional position different than that adopted by the Commission in Opinion No. 770 was briefly mentioned by only one party in the initial comments. The Commission, despite the fact that it was one of the fundamental elements of its rate design, did not even refer to the issue in its itemization of thirteen specified issues it wanted addressed at oral argument in its Order of September 2. Nor can the "catch-all" provision serve as adequate notice on which to fundamentally change the contemplated scope of the proceeding. Thus, Producers were confronted with a *fait accompli* when, without notice, the Commission sub-

16. 52 F.P.C. 263.

17. Docket No. R-389-B, *Order on Applications and Motions for Rehearing, Reconsideration and Clarification*, 51 F.P.C. 2262 (3/7/75); *Order on Clarification*, ___ F.P.C. ___ (3/31/77).

stantially modified its "new" gas definitions in its final order.

This change in the scope of the proceeding at the last moment violated the Administrative Procedure Act[18] and the Fifth Amendment of the Constitution.[19] Turning first to the Administrative Procedure Act, Section 553 requires that the Commission, before changing already promulgated rules,[20] provide interested parties notice and opportunity to comment. Subsection 553(b)(3) requires that notice include either the terms or the substance of the proposed rule or a description of the subjects and issues involved. Clearly, the Commission's initial notice here did not contain the terms or substance of a proposed change in the "new" gas definitions. In fact, it by its own terms indicated the continuation of existing policy. This omission was not cured by the September 2 Order. Therefore, since there was no effective notice that a major change in the existing rate design was contemplated — as the change in the "new gas" definition was, the change in definition as finally ordered in Opinion No. 770-A is invalid. *Pickus v. United States Board of Parole*, 165 U.S. App. D.C. 284, 507 F.2d 1107 (D.C. Cir. 1974); *Buckeye Power, Inc. v. Environmental Protection Agency*, 481 F.2d 162 (6th Cir. 1973); *Texaco Inc. v. FPC*, 412 F.2d 740 (3d Cir. 1969).

Further, the Commission violated Petitioners' right to due process of law under the Fifth Amendment. Under

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18. 5 U.S.C. § 551 *et seq.* (1970). Hereinafter all references are to United States Code Sections.

19. U.S. Const., Amend. V.

20. Section 551(5) defines a rulemaking proceeding, to which Section 553 is applicable, as an "agency process for formulating, amending, or repealing a rule."

apposite Supreme Court precedent, Producer's contract rights which are based on area rate clauses in contracts executed prior to Opinion No. 770-A, to collect the just and reasonable 1973-1974 and 1975-1976 rates for gas dedicated to interstate commerce during those biennia and to be sold during the remaining terms of the contracts, are constitutionally protected property interests. Those contract rights are based on explicit provisions in written agreements, and thus are not mere unilateral expectations of benefits, but rather are legitimate, contractual claims of entitlement. *Perry v. Sindermann*, 408 U.S. 593, 601-02; *Board of Regents v. Roth*, 408 U.S. 564, 577.

The process due Petitioners in this case was notice of and opportunity to submit written comments on the repeal of the new dedication provisions before the issuance of Opinion No. 770-A. The fundamental meaning of due process is that persons whose rights are to be affected are entitled to notice and opportunity to be heard. *Fuentes v. Shevin*, 407 U.S. 67. The notice must be timely and adequate, *Goldberg v. Kelly*, 397 U.S. 254; that is, it must be reasonably calculated to apprise interested persons of the issues involved and afford them reasonable time to present comments. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306. But as shown *supra*, neither the initial notice nor any other proceedings in Docket No. RM75-14 prior to issuance of Opinion No. 770-A, reasonably informed Petitioners that deletion of the initial sales provisions was at issue. This action gravely subverted the integrity of the administrative process.

Finally, because of the notice defect, there is no substantial evidence to support the Commission's change.

II. The Court Of Appeals Improperly Applied The "End Result" Test In Affirming The Commission's Reimposition Of Vintaging.

The Commission's imposition of vintaging of "new" gas fails the "end result" test announced by this Court in its decision in *Permian I*. In explaining the test and the measurement of whether a particular rate established by the Commission satisfied the standard, this Court stated:

> A price is thus just and reasonable within the meaning of §§ 4(a) and 5(a) [of the Natural Gas Act] not merely because it is "somebody's idea of a return on a 'rate base,'" but because it results in satisfactory programs of exploration, development and production.[21]

The Commission previously rejected continuation of the concept of vintaging based upon its finding that:

> This uniform price will constitute a recognition of the fact that gas is a consumable, irreplaceable commodity and not a service which can be renewed by man. Thus, there is *no rational basis* for setting differing price levels based upon date of a discovery, lease acquisition, contract or well commencement or completion over an extended period of time.[22]

Despite this finding that "no rational basis" existed for continuing vintaging of natural gas because of its non-renewable nature, the Commission in its opinion here under review suddenly abandoned this previously announced policy because of "demonstrable cost differences associated with various

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21. 390 U.S., *supra*, at 796.

22. 32 F.P.C., *supra*, at 1637-38 [emphasis added].

vintages of gas" and because of the resulting "impact on the public."[23] The Court of Appeals affirmed the Commission, finding that the Commission was fully justified, in light of these conditions, in reversing its previous position.

Both the Court of Appeals and the Commission have ignored the fundamental requirement established by this Court in *Permian I*. The Commission had the obligation to consider the consumer interests; however, those interests are served by designing a rate structure which will elicit further investment and resulting exploration, development and production of new supplies of natural gas. Further, the interests of the consumer are not served by shielding the consumer from the economic cost of replacing the units of gas consumed. It is the very fact that the costs of finding and producing natural gas have risen so dramatically with each passing year that the rate established for the units of natural gas consumed should be high enough to generate the capital required for its ultimate replacement, as well as its conservation.

As stated in the past by this Court, the function of the regulatory agency is to approximate through regulation those responses which would occur in a truly competitive market.[24] Although this Court in the past has approved vintaging,[25] neither the size of the differential here contemplated, the large revenue deficiency resulting from the reimposition of vintaging, nor the magnitude of the existing shortage of natural gas confronted the

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23. JA 737.

24. *FPC v. Texaco Inc.*, 417 U.S. 380 (1974); *FPC v. Sunray DX Oil Co.*, 391 U.S. 9 (1968).

25. *E.g., Permian I.*

Court. The Commission's current return to vintaging, in light of these circumstances, cannot withstand the scrutiny required by this Court's "end result" test of *Permian I*, particularly in light of the Commission's previous finding that because of the irreplaceable nature of natural gas, no rational basis for continuing vintaging can exist.

III. The Court Of Appeals Erred In Affirming The Commission's Cost Estimates, Because Such Cost Estimates Are Patently Defective.*

This Court in *Permian I* approved the Commission's discretion to select various relevant costing components in arriving at a cost estimate. In the Commission's orders here under review, rates of $1.42 per Mcf for qualifying post-December 31, 1974 gas and $.93 per Mcf for qualifying 1973-1974 biennium gas were found to be just and reasonable. These rates are "cost-based and justified" (JA 301), that is, determined in relation to costs of exploration, development and production as estimated by the Commission based on the record in the proceeding. Thus, the rates purportedly allow recovery of costs plus a 15% overall rate of return on investment (JA 302-04). There are, however, several errors in the Commission's costing estimate which are so patent and obvious that the failure to correct these errors manifestly resulted in cost estimates which fail to yield the rate of return required by the public interest. Producers will point out only four of these costing errors, which have the most substantial impact. The uncertain nature of attempting to determine a "cost" of natural gas reemphasizes our first and second points, *supra* — that the Commission cannot rely solely upon such cost studies in satisfying the "end result" test of *Permian I* for determining whether

producer rates established by the Commission in area ratemaking are just and reasonable.

A. The Commission Failed To Cope With The Declining Trend In the Productivity Of Gas Exploration And Production.

Among the more significant errors in the Commission's cost estimations, and one which substantially distorts the entire rate determination, is its estimate of the current productivity of gas well drilling.

As used in the *Permian I* costing methodology, the term "productivity" is defined as the relationship between non-associated gas reserves currently being added to the nation's gas supply inventory and the successful gas well footage drilled to discover and develop those additional reserves. Mechanically, the productivity factor used in the Commission's new gas costing calculations is obtained by dividing the estimated non-associated gas reserves added during a particular year or other specified length of time by the total successful gas well footage drilled during the same specified period of time.

The Commission recognized in Opinion No. 770 that "productivity in terms of Mcf for a successful foot drilled is the cornerstone of the analysis used to determine the cost for 'new' gas" (JA 337). In Opinion No. 770, the Commission employed an 8 to 9-year productivity range and, within that range, selected a productivity factor of 300 Mcf per successful foot drilled (JA 347-349, 624).

While recognizing in Opinion No. 770-A that "a significant downward trend in productivity has been experienced since 1968" (JA 635), the Commission mitigates

the effect of this trend by increasing the number of historical years included within the average in calculating the productivity component. The Commission highlighted this defect when it correctly described the productivity factor to be sought as follows:

> "The final determination with respect to the appropriate estimate of productivity rests largely upon judgment that reflects consideration of a productivity that realistically may be achieved *in this biennum* and a productivity that yields a price adequate to induce the necessary drilling activity." (Emphasis added, JA 349).

Examination of actual productivities set forth in Opinion No. 770 (JA 340) shows that an average productivity of 300 Mcf per foot is higher than any of the actual productivities for the years 1972-75. Since the 1975 productivity was only 237 Mcf per foot, the productivity for 1976 would have to approximate 363 Mcf per foot in order to average the 300 used by the Commission for the 1975-1976 biennium.[26] A productivity of 363 has not occurred since 1971. Obviously, in selecting an average of 300 Mcf per foot, the Commission ignored the downward trend in productivity. Instead, it has predicted that history will reverse itself in estimating a higher productivity in the 1975-1976 biennium. This speculation is unrealistic and its employment in Opinion No. 770 constitutes an abuse of the Commission's discretion.

There was no new evidence in the record below which supported any increase in the number of years to be

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26. In fact, the actual productivity for 1976 was only 156 Mcf per foot.

used in computing an average productivity that would be most representative of future drilling efforts. Rather the evidence of record is to the contrary and dictates the use of a shorter average time span or the use of a productivity trending technique rather than averages. Had the Commission maintained the judicially-approved 7-year average[27] (which in this proceeding would have covered the years 1969-1975), which is itself an excessive time period, the resulting initial rate would have been at least $1.73 per Mcf simply correcting for productivity alone, rather than the initial rate of $1.42 per Mcf determined by the Commission.

B. Other Errors In The Commission's Estimates Understated The Cost Of Finding And Producing Natural Gas During The 1975-76 Biennium.

1. Timing of Expenditures.

In Opinion Nos. 770 and 770-A, the Commission properly continued to employ the discounted cash flow (DCF) analysis it initiated in Opinion No. 699-H.[28] This method explicitly takes into account the size and timing of investment outlays relative to the size and timing of subsequent receipts from those investment outlays. In the DCF analysis used to determine the rates in Opinion No. 770, the Commission made an error that is strictly mathematical, not judgmental. This mathematical error affects the amount of return due as a result of the elapsed time between cash outflows and cash inflows. The result

27. *Shell Oil Co. v. FPC*, 520 F.2d, *supra*, at 1078-79.

28. 52 F.P.C. 1604, 1615.

of this error is that the timing pattern incorporated in the DCF analysis by the Commission is one-half year less than the Commission has stated it is using, with the result being that the new gas price is further understated by almost $.12 per Mcf, excluding any adjustments for productivity.

2. Price Escalation.

In determining the rate for 1975-76 gas, the Commission found the cost-based price to be $1.61 per Mcf assuming a level or constant price (JA 682). However, the Commission chose to adopt an escalating rate design beginning at $1.42 per Mcf in 1976 and escalating $.01 per quarter for a total of $.04 per year. This rate design was justified on the basis that a properly constructed escalator "might avoid the need for vintaging the 1975-76 gas in a subsequent biennial review" (JA 398). While Producers support elimination of vintaging, we are confronted by the stark reality that cost-based rates are reduced at the outset from $1.61 per Mcf to $1.42 per Mcf. Producers are expected to be indifferent towards this $.19 per Mcf actual difference because "the revenue stream with the escalator has the same present value as it would with a level price" (JA 683). However, this rate design deprives producers of the presently-justified cost-based rate of $1.61 per Mcf with the sole assurance that the Commission is "committed to permit the price of gas from wells drilled during the current biennium to escalate by at least the amount chosen here or its comparable present value . . ." (JA 683). This assurance does not provide for the probability that the $1.61 per Mcf rate will be determined to have been understated in future review proceedings when additional historical data

are available. In such event, the $1.42 escalating rate presumably will be adjusted, but producers will have suffered irretrievable loss of the difference between $1.61 and $1.42 plus escalation for all gas sold prior to the rate adjustment.

3. Drilling Cost.

Finding that "extraordinary inflation of recent years suddenly has affected drilling costs to a degree that no substantial statistical trending method would yield an accurate prediction" (JA 352), the Commission in Opinion No. 770 rightly utilized the most accurate published index of actual industry costs as the basis for estimating drilling costs for the 1975 "test year". While expressly emphasizing numerous published indicators uniformly showing "continued upward pressure upon oil and gas-well drilling costs" (JA 354), the Commission astonishingly refused to adjust the 1974 Joint Association Survey costs to 1975 dollars and insisted on utilizing an average of 1973-1974 costs as the basis for adjustment. This procedure would be reasonable only if there were some rational basis for doubt as to whether there is indeed "continued upward pressure" of these costs. The Commission's unwarranted refusal to use 1974 costs as the adjustment base results in an understatement of the rate for post-December 31, 1974 gas of 3.7 cents per Mcf, excluding productivity and timing adjustments.

CONCLUSION

The Court of Appeals, in affirming the Commission in the instant matter, committed errors of law, to the detriment of the undersigned producers. If this Court decides

independently to grant any other petition for a writ of certiorari concerning the Commission's orders, the questions raised herein should also be considered by the Court.

Respectfully submitted,

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APPENDIX I

U. S. CONSTITUTION, AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

SECTION 4, NATURAL GAS ACT, 15 U.S.C. § 717c.

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer

or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rate or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall

be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SECTION 5, NATURAL GAS ACT, 15 U.S.C. § 717d.

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the

cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

SECTION 7, NATURAL GAS ACT, 15 U.S.C. § 717f.

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abando[illegible] all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the

continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided

in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations, of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted

thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or

proceeding in the courts of the State where the property is situated: *Provided,* That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

SECTION 19, NATURAL GAS ACT, 15 U.S.C. § 717r.

(a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such

proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure to do so. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commis-

sion may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28.

(c) The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

28 U.S.C. § 1254

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree.

28 U.S.C. § 2101(c)

(c) Any other appeal or any writ of certiorari intended to bring any judgment or decree in a civil action, suit or proceeding before the Supreme Court for review shall be taken or applied for within ninety days after

the entry of such judgment of decree. A justice of the Supreme Court, for good cause shown, may extend the time for applying for a writ of certiorari for a period not exceeding sixty days.

SECTION 3, ADMINISTRATIVE PROCEDURE ACT, 5 U.S.C. § 553

(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(b) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of this Conditional Cross-Petition for Writ of Certiorari in accordance with Rule 33 of the Supreme Court of the United States.

November 14, 1977
Houston, Texas

/s/ PAUL W. WRIGHT
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